

# ICPS newsletter

## Public-at-large partakes in tax system reform

*The establishment of a stable tax system requires a meticulous study of reform options, in particular, the evaluation of their implications and feasibility. This was the conclusion arrived at by participants of the public hearings on "Tax Reform: A Common Vision", in the course of which representatives of the Verkhovna Rada of Ukraine, the executive government, national and foreign companies, and Ukrainian and foreign experts discussed the major problems of the current tax system and ways to ameliorate it*

On 16 October 2002, the Committee on Finance and Banking Activity of the Verkhovna Rada of Ukraine, the International Centre for Policy Studies (ICPS), and the Support for Economic and Fiscal Reform Project (SEFR), which provided sponsorship, held public hearings titled "Tax Reform: A Common Vision". This discussion was the first in a series of five planned public hearings aimed at identifying the major viewpoints on key tax policy issues. Its chief objective was to build public awareness of tax policy goals, and to foster a shared view on the social priorities and specific measures of the tax reforms to be implemented.

In their introductory presentations, the organisers highlighted the importance of conducting such events to ensure the transparency and openness of law-making processes, a critical analysis of legislative initiatives, and taking into account the interests of all stakeholders when drafting the new Tax Code of Ukraine, which is to be tabled in the near future in the Verkhovna Rada of Ukraine. Specifically, the MP Taras Dovhy emphasised that the principle drawbacks of the extant tax legislation are instability, possibilities of ambiguous interpretation, and a lack of focus on supporting the business sector.

The seminar proceeded with the participants discussing possible improvements to the current tax system, namely:

- What kind of tax system should be established in Ukraine—one which will

combine high taxes and high levels of social security, or one which will offer a low level of social security and more opportunities for businesses?

- Should the state tax policy ensure equal opportunities for all economic entities, or should specific economic sectors be stimulated, with tax benefits being left intact?

- Should the tax pressure be mitigated by reducing the tax rate, or should the system of accounting of corporate expenditures be overhauled?

The second part of the seminar involved working discussions in groups. The following five working groups were formed, representing the following interest groups:

- (1) government (experts from the Ministry of Finance of Ukraine, the State Tax Administration, the Ministry of Economy of Ukraine);
- (2) Ukrainian businesses;
- (3) foreign businesses;
- (4) Ukrainian NGOs; and
- (5) international organisations.

Participants of each group had to answer the following questions:

- What are the social goals of the tax policy?
- In what way does the tax policy affect investment climate for both domestic and foreign investors?
- What are the most topical problems to be addressed immediately?
- What are the ways to resolve these problems, impediments, short-term and long-term consequences of various actions?

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### Dear readers!

We invite you to participate in the next tax reform discussions

- The value-added tax: reform options
- The corporate profit tax: reform options
- Wrap-up seminar on tax policy

For more details about the dates and participation in public hearings, please contact Tetyana Shvatska at tel. (38-044) 236-3740, 236-4477, e-mail: [tshvatska@icps.kiev.ua](mailto:tshvatska@icps.kiev.ua)

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### The chief objective is to create a stable tax system

Representatives of the different groups shared the following viewpoints:

- The tax policy goal is to procure funds to ensure the execution of the state's obligations, but in such a way that it does not hamper economic and social development;
- The key problems of the current tax system boil down to a lack of stability and transparency of tax legislation, possibilities of ambiguous interpretation, as well as inconsistency of norms;
- The tax system should be reformed by expanding the tax base and reducing tax rates, as well as by simplifying the administration system, and eliminating legislative ambiguity and contradictions.

### Businesses oppose the existing draft of the Tax Code

Government and business representatives voiced the same tax policy goals, while their prioritisation of these goals varied. The government believes that the most important thing is to procure sufficient revenues to ensure the execution of obligations, while for business representatives the

most important factor was an environment conducive for economic development. Representatives of international organisations believe that the goal of tax policy should be to foster social equality and fairness.

Government and business representatives gave different assessments of the draft Tax Code. Government officials emphasised that there are well-defined procedures and coordinated stages of adoption of the Tax Code, and that they consider the drafted Tax Code to be altogether acceptable. In contrast, business representatives did not support the current draft Tax Code and believe that it should never be implemented, since it does not solve the key problems of the current taxation system.

Business representatives believe that the failure of the current draft Tax Code were due to the following reasons:

- lack of strategy of tax system reform;
- lack of methodology for the drafting and economic analysis of legislative acts to alter the taxation system, and absence of a logical approach to fixing tax rates;
- struggle of interest groups for each separate provision of the Tax Code, combined with the government's or parliament's failure to stimulate strategic national interest;
- no well-structured dialogue between the society and the government.

Business representatives suggested the following assessment criteria for the options to introduce changes in the tax system:

- impact on the business climate and long-term investment;
- ease of tax administration;
- increase of real household incomes;
- equality of terms for Ukrainian enterprises, as well as Ukrainian and foreign enterprises;
- conformity of Ukraine's tax legislation to international norms, specifically, to the norms of the European Union.

## Substantial analysis is required to get tax policy approved

Representatives of businesses, NGOs, and the State Committee on Regulatory

## Comments of participants in the discussion

### What is the best way for Ukraine—the liberal or European one?

**Volodymyr Bury**, Bizpro project: We have to answer the key question: where are we going as a state? The first option: we are a liberal country with low social security and abundant opportunities and the government is being straightforward, saying, "we have no benefits, minimal social security, but our taxes are minimal and liberal. Another way is the European one, with steep taxes, high social security, there are a lot of benefits and every citizen is entitled to demand many services from the state, because he/she paid taxes. If this chief query is not answered, discussion about the necessity of certain types of activity or the size of tax rates is groundless.

### Taxes should diversify budget revenue sources

**Robert Conrad**, international consultant on tax policy issues: We should have a clear idea of how the tax system elements merge into one, especially in the economy, which is now in the transition stage. The government needs a robust economy; when the economy is in a cheerful state, the government is in high spirits. As any investor, the government cannot rely on only one revenue source. Therefore, when devising the tax system, the government's objective is to diversify revenue sources so that different instruments to attain a specific goal could be employed as the economy goes through the transition stages.

### Equal rules or priority sectors?

**Antonina Palamarchuk**, Association of Ukrainian banks: if today's goal is to make the country pass on to a higher development level, if we claim that we need money and we search for it all over the world, then let us consider what kind of source for Ukraine is the money of its population. In Ukraine, taking into account that average citizens mistrust the government, after all their savings had devaluated in savings banks, we should be fully aware of the importance of encouraging people to save their money in the banking system. Therefore, we believe that it is too early to expand the tax base at the expense of taxing interest on deposits.

**Vasyl Rehuretsky**, Ministry of Finance of Ukraine: the problem of taxing interest on deposits, in my opinion, is related to the most important problem in Ukraine's tax system reform, which runs as follows. We have to resolve the problem of reducing the burden on specific taxpayers by expanding the tax base. Presently, we have to answer the question of whether it will be right, when declaring this principle, still not to impose taxes on certain sectors, because they are assigned a special role in the economy?

Policy and Entrepreneurship proposed to undertake the following measures to implement the tax reform:

- devise the tax policy;
- publicly discuss and approve the stages of Tax Code adoption, and appoint a person in charge of the reform process, establishing public control over the execution of all stages;
- raise public awareness and publish a government paper outlining tax policy directions;
- not to embark on changes to the tax legislation if the alternatives for changes are not identified, their

implications are not analysed, or their economic feasibility is not justified;

- apply a scientific approach to evaluate proposed changes to the tax system;
- harmonise the draft Tax Code with Western standards;
- impose liability on officials for actions or negligence which were to the detriment taxpayers;
- involve business representatives in the Tax Code drafting process;
- organise training of experts on tax policy issues and on the legislation of the European Union. ■

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